Important Note : 1. On completing your answers, compulsorily draw diagonal cross lines on the remaining blank pages.
2. Any revealing of identification, appeal to evaluator and /or equations written eg, 42+8 = 50, will be treated as malpractice.

CBCS SCHEME

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20MBAFM306

Third Semester MBA Degree Examination, Jan./Feb. 2023
Advanced Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1. ***Answer any FOUR full questions from Q.No.1 to Q.No.7.***
2. ***Question No. 8 is compulsory.***

1 a. What is the Annual P-interest cost associated with following credit terms :
i) 1/10 net 30 ii) 3/10 net 45. **(03 Marks)**

b. What is EOQ? What are its assumptions? **(07 Marks)**

c. What do you mean by Working Capital? Briefly explain the different sources of Financing working capital. **(10 Marks)**

2 a. Which are the costs involved in Credit Management? **(03 Marks)**

b. XYZ Company has currently an ordinary share capital of Rs 25 lakh, consisting of 25,000 shares of Rs 100 each. The management is planning to raise another Rs 20 lakhs to finance a major programme of expansion through one of 3 possible financing plans. The options are as under.
i) Entirely through ordinary shares.
ii) Rs 10 lakh through ordinary shares and Rs 10 lakh through debt @ 15%.
iii) Rs 10 lakh through ordinary shares and Rs 10 lakh through preference shares with 14% dividend. The Company's expected EBIT will be Rs 8 lakh. Assuming a corporate tax rate 50%. Determine EPS for each alternative. **(07 Marks)**

c. What is Optimal Capital Structure? Discuss the factors influencing on capital structure. **(10 Marks)**

3 a. What is Working Capital Leverage? How it is calculated? **(03 Marks)**

b. Discuss the factors influencing on dividend policy. **(07 Marks)**

c. From the following data, determine the value of firms P & Q under :
i) Net Income (NI) approach.
ii) Net Operating Income (NOI) approach.

Particulars	Levered firm 'P'	Inlevered firm 'Q'
EBIT	Rs 2,25,000	Rs 2,25,000
Interest @ 15%	Rs 75,000	-
Ke	20%	20%
Corporate tax rate	50%	50%

(10 Marks)

4 a. List out 5C's of Credit Policy. **(03 Marks)**

b. Consider the data for Arun & Co.

Current Assets	Amt.	Current Liabilities	Amt.
Inventory	70	Trade Creditors	40
Debtors	60	Provisions	20
Cash	15		
	145		60

What is the MPBF for Arun & Co. under the methods suggested by Tandon Committee? Assume the core current assets are Rs 60 million. **(07 Marks)**

c. An Engineering Company has a cost of Equity capital of 15%. The current market value of the firm is Rs 30,00,000 @ Rs 30 per share. Assume value for investment Rs 9,00,000, Earnings Rs 5,00,000 and total dividend Rs 3,00,000 and show that under the MM assumptions, the payment of dividend does not affect the value of the firm. **(10 Marks)**

5 a. List out the Cash Management strategies. **(03 Marks)**

b. The following information is available in respect of the rate of return on investment, Ke and EPS of a manufacturing company. r = i) 12% ii) 11% iii) 10%
Ke = 11% ; EPS = Rs 20.
Determine the value of items as per Gordan's model and Walter model if dividend payment ratio is 40%. **(07 Marks)**

c. A Company currently has annual sales of Rs 5,00,000 and an average collection period of 30 days. It is considering a more liberal credit policy. If the credit period is extended, the company expects sales and bad – debts increases in the following manner.

Credit policy	Increase in Credit period	Increase in Sales (Rs)	Bad debts % of sales
A	10 days	25,000	1.2
B	15 days	35,000	1.5
C	30 days	40,000	1.8
D	42 days	50,000	2.2

The selling price per unit is Rs 2. Average cost per unit @ the current level of operations is Rs 1.50 and variable cost per unit is Rs 1.20. If the current bad debt loss is 1% of sales and the required rate of return on investment is 20%, which credit policy should be undertaken? Ignore taxes and assume 360 days in a year. **(10 Marks)**

6 a. What are the steps involved in numerical credit scoring? **(03 Marks)**

b. A annual cash requirement of A ltd is Rs 10 lakh. The company has marketable securities in lot sizes of Rs 50,000 , Rs 1,00,000 , Rs 2,00,000 , Rs 2,50,000 and Rs 5,00,000. The cost of conversion of marketable securities per lot is Rs 1000. The company can earn 5% yield on its securities. You are required to prepare a table indicating which lot size will have to be sold by the company also show the economic lot size can be obtained by the BAUMOL model? **(07 Marks)**

c. Two companies A & B belong to the same risk class. The two firms are identical in every respect except that firm A has 10% debentures. The valuation of two firms as per traditional theory is as follows :

Particulars	A	B
Net Operating Income (EBIT)	22,50,000	22,50,000
Interest on debt	1,50,000	-
Earnings to equity holders (NI)	21,00,000	22,50,000
Equity capitalization rate (Ke)	0.14	0.125
Market value of equity (S)	1,50,00,000	1,80,00,000
Market value of debt (B)	15,00,000	-
Total market value of the firm (V)	1,65,00,000	1,80,00,000
Overall cost of capital	13.64%	12.5%

Show the arbitrage process by which an investor who holds shares worth Rs 22,500 in Company 'B' will be benefited by investing in Company 'A'. **(10 Marks)**

7 a. What are the assumptions of NI approach? **(03 Marks)**

b. A firm uses a continuous billing system that results in an average daily receipts of Rs 40 lakhs. It is contemplating the institution of concentration banking instead of the current system of centralized billing and collection. It is estimated that such a system will reduce the collection period of account receivable by 2 days. Concentration banking would cost Rs 75,000 annually and 8% can be earned by the firm on its investments. It is also found that a lock – box system could reduce overall collection time by 4 days and could cost annually Rs 1,20,000.

i) How much cash would be released with the concentration banking system?

ii) How much money can be saved due to reduction in the collection period by 2 days? Should be firm institute concentration banking system?

iii) How much cash would be freed by lock – box system?

iv) Between concentration banking and lock – box system which is better? **(07 Marks)**

c. ABC Ltd. Produces a product which has a monthly demand of 4000 units. The product requires a component 'X' purchased @ Rs 20. For every finished product, one unit of component is required. The ordering cost is Rs 120 per order and the holding cost is 10% per annum. You are required to calculate :

i) EOQ.

ii) If the minimum lot size to be supplied is 4000 units, what is the extra cost, the company has to incur?

iii) What is the minimum carrying cost the company has to incur? **(10 Marks)**

8 **<u>CASE STUDY</u> (Compulsory)** :

The following data pertains to a shop. The owner has made sales forecasts for the first 5 months of the coming year as follows :

January	40,000
February	45,000
March	55,000
April	60,000
May	50,000

Other data is as follows :

a. Debtors and creditors balances @ the beginning of the year are Rs 30,000 and Rs 14,000 respectively. The balances of other relevant assets and liabilities are

Cash balance	7,500
Stock	51,000
Accrued sales commission	3,500

b. 40% sales are on cash basis credit sales are collected in the month following the sale.

c. Cost of sales is 60% of sales.

d. The only other variable cost is a 5% commission to a sales agents. Sales commission is paid in the month after it is earned. i.e. time lag 1 month.

e. Inventory is kept equal to sales requirements for the next two months budgeted sales.

f. Trade creditors are paid in the month following purchases.

g. Fixed costs Rs 50,000/pm, including Rs 2,000 depreciation.
You are required to prepare cash budget for the first 3 months. **(20 Marks)**

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